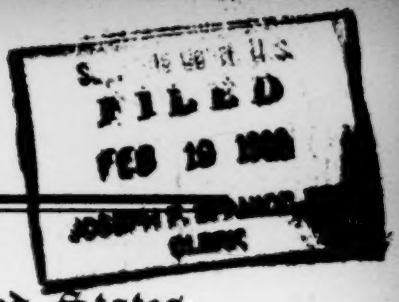
No. 87-1179



IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

RUSSELL T. WEIL and VIRGINIA L. WEIL,
STUART S. DYE and MARY I. DYE,
ROBERT J. HICKEY and ELEANOR L. HICKEY, and
RUSSELL T. WEIL, RONALD L. CAPONE, and
JILDA C. GARITY, as Executor, Administrator cta,
and Administratrix cta, respectively, of the Estates
of Ronald A. Capone and Margaret L. Capone,
Appellants,

v.

RODERICK G.W. CHU, FRANCIS KOENIG, and
MARK FRIEDLANDER, constituting the
State Tax Commission of the State of New York,
Appellees.

ON APPEAL FROM THE COURT OF APPEALS OF THE STATE OF NEW YORK

APPELLANTS' REPLY TO MOTION TO DISMISS OR AFFIRM

February 19, 1988

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TABLE OF CONTENTS

I. Appellees' Contentions Regarding The Source of Appellants' Incomes From Their Legal Practice..... 2

II. Appellees' Contentions Regarding Their Denial of Tax Credits To Appellants..... 8

III. Appellees' Contentions Regarding Their §637(d) Agreement With Appellants..... 11

IV. Conclusion..... 15

TABLE OF AUTHORITIES

Cases	Page
American Commuters Assoc. v. Levitt, 405 F.2d 1148 (2d Cir. 1969).....	3
Aurora Corp. v. Tully, 60 N.Y.2d 338 (1983).....	11
Austin v. New Hampshire, 420 U.S. 656 (1975).....	9
Complete Auto Transit v. Brady, 430 U.S. 274 (1977).....	4
Craik v. United States, 31 F.Supp. 132 (Ct. Cl. 1940).....	3
Matter of Goodwin v. State Tax Comm., 286 A.D. 694 (1955), affd, 1 N.Y.2d 680 (1956), appeal dismissed, 352 U.S. 805 (1956).....	10
Miller v. United States, 500 F.2d 1007 (2d Cir. 1974).....	15
Shaffer v. Carter, 252 U.S. 37 (1920).....	4
Shuster v. Commissioner, 312 F.2d 311 (9th Cir. 1962).....	15
Simmons v. United States, 308 F.2d 938 (5th Cir. 1962).....	15
Tax Review Board v. D.H. Shapiro Co., 185 A.2d 529 (Pa. 1962).....	3
Toomer v. Witsell, 334 U.S. 385 (1948).....	10

Travelers' Insurance Co. v. Connecticut, 185 U.S. 364 (1902)... 10

Travis v. Yale & Towne Mfg. Co., 252 U.S. 60 (1920)..... 2, 9

Westinghouse Electric Corp. v. Tully, 466 U.S. 388 (1984)..... 9

Williams v. Hartshorn, 296 N.Y. 49 (1946)..... 5

Williams v. Vermont, 472 U.S. 14 (1985)..... 9

Statutes And Regulations

Tax Law of New York, 59 McKenney's Consolidated Laws of N.Y. Ann.:

Section 601(b)..... 5
Section 637(d)..... 11-13

United States Code Of Federal Regulations:

26 C.F.R. §301.6362-5(d)(1)..... 3

Other Authority

Hellerstein, Some Relections on the State Taxation of A Nonresident's Personal Income, 72 Mich. L. Rev. 1309, June 1974..... 11

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ON APPEAL FROM THE COURT OF APPEALS
OF THE STATE OF NEW YORK

APPELLANTS' REPLY TO MOTION TO DISMISS OR AFFIRM

Appellants hereby briefly reply to the "Motion To Dismiss Or Affirm" filed by appellees in this case.

I. Appellees' Contentions Regarding The Source of Appellants' Incomes From Their Legal Practice

Appellees' motion fails to address the real facts of appellants' case or the case law cited in appellants' Jurisdictional Statement ("J.S."). For example, appellees' motion (p. 7) discusses the due process issue in less than one sentence, simply repeating the issue rather than establishing a bona fide New York source. Appellees merely state that taxes on nonresident individuals have been constitutionally upheld where they have "sources" within the state.[1] Appellees in the same sentence similarly conclude, without discussion, that there is no equal protection or privileges and immunities problem,

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[1] Appellees cite Travis v. Yale & Towne Mfg. Co., 252 U.S. 60 (1920). The case is inapposite as to the source issue for numerous reasons, including the fact that it involved taxation of employees of a Connecticut corporation doing business in New York, and there was no substantive dispute about income "source."

citing one inapplicable case for both issues.[2] Moreover, appellees make no mention of the numerous statutory and regulatory provisions cited by appellants for determining "source" (see J.S. 25-26 n.9).[3]

Rather, appellees essentially predicate their entire argument on the contention that appellants must be taxed because their partnership has a New York office, thus admitting that their argument focuses on

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[2] American Commuters Assoc. v. Levitt, 405 F.2d 1148 (2d Cir. 1969). The case did not involve a partnership situation, the nonresident taxpayers were employees of a New Jersey corporation who actually commuted and worked in New York, and the plaintiffs in that case admitted that they received both earned income and substantial benefits from doing business in New York.

[3] For example, the IRS regulation codified at 26 C.F.R. §301.6362-5(d)(1) requires that personal service income "shall be considered to have been derived from sources within a state only if the services of the taxpayers, which gave rise to the income, are performed in such state." See also Craik v. United States, 31 F.Supp. 132 (Ct. Cl. 1940); Tax Review Board v. D.H. Shapiro Co., 185 A.2d 529 (Pa. 1962).

the income of the partnership, not that of the nonresident individuals. Appellees' motion (p. 7) asserts that "the activity taxed here has a substantial nexus to New York" solely because appellees focus only on the "activity" of the partnership, rather than individual appellants' legal practice, which produces their incomes.[4] Appellees' erroneous focus leads them to incorrectly state that appellants "performed services for [their] partnership" (motion, p. 2), when, in fact, they

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[4] Appellees cite Complete Auto Transit v. Brady, 430 U.S. 274 (1977), and Shaffer v. Carter, 252 U.S. 37 (1920), regarding the interstate commerce issue. Appellees conclude that the requirements of Complete Auto Transit are met in this case only because they cite the activities of appellants' New York partners rather than appellants' legal practice in Washington. As to the Shaffer decision, that case concerned an individual nonresident who engaged in business in Oklahoma: he purchased, developed and operated land leases in Oklahoma, which assessed an income tax thereon. The case had nothing whatever to do with a partnership arrangement, a distributive share tax assessment, or any of the other relevant issues.

clearly performed services for their clients in Washington, D.C. (J.S. 8-10). Similarly, appellees erroneously place emphasis on the partnership's "bookkeeping department" in New York (motion, p. 3), while ignoring the fact that all of appellants' records relating to client services and billing were kept in Washington (J.S. 9-10, 18a-19a).

Clearly, the factor for determining the "source" of a partner's income is where the individual performs his services, not the location of the partnership's offices. The tax assessment involved in this case is against the individual appellants, not their firm. Indeed, under New York law, a partnership is not a taxable entity, Williams v. Hartshorn, 296 N.Y. 49 (1946), and Section 601(b) of the New York Tax Law specifically provides that:

> A partnership as such shall not be subject to tax.... Persons carrying on business as partners shall be

> liable for tax...only in their separate or individual capacities. [Emphasis added].

In attempting to support their legal position, appellees also contend that all appellants' incomes belong initially to the partnership, with no separate property right in the income until distribution, that a partner's interest is his share of the profits and surplus, and that under appellants' partnership agreement gross fees earned by the partners were fees of the firm (motion, p. 7-8). Again, appellees are misfocusing the issue on a non-taxable entity, the partnership, instead of the individual partners and the place where the services giving rise to the taxable income are performed. The individual rights a partner may or may not have as to specific assets of the firm or what the distributive share may be for each partner is irrelevant to the source argument. The question is the "source" of

the income appellants received and whether that source is New York. Moreover, the record does not support any assertion that all money earned by appellants belonged to the partnership as a whole, or that each partner's interest equaled his share of the profits and surplus. In fact, appellants retained earnings from their legal services to pay their expenses, and partnership shares were used only as a starting point to determine distribution (J.S. 10, 25 n.9).

Finally, appellees contend (motion, p. 8) that payment of appellants' distributive share depended on the profitability of the partnership as a whole, and that if the partnership suffered a loss, or if the New York office generated less profits, appellants' distributive shares would have been less. No citation to the record is given for these unsupported theories. Indeed, no correlation existed between the

money received by the firm and appellants' distributive shares (J.S. 10, 25 n.9). Appellants' Washington office subsidized the New York office such that the New York partners' income-producing activities could have dropped with no affect on the amount distributed to appellants (Id.).

II. Appellees' Contentions Regarding Their Denial Of Tax Credits To Appellants

Appellees' motion insists that New York State may constitutionally deny non-residents the credit provided to New York residents for taxes paid to other states and political subdivisions. However, none of the cases cited in appellees' motion (pp. 9-11) upholds disparate treatment of residents and nonresidents in regard to tax credits. Indeed, the cited cases support appellants' position since they condemn

disparate treatment based on nonresidency alone.[5]

Appellees urge that the credit is merely designed to avoid "double taxation of income," which they erroneously assume to be a problem that affects only New York residents (motion, p. 10). In fact, double taxation is a problem that appellants indisputably face as a result of appellees' efforts to tax their income (J.S. 27 n.10), and it is unconstitutional to afford residents relief from double taxation while denying appellants relief from the very same problem. Williams v. Vermont, 472 U.S. 14, 27 (1985).

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[5] Appellees' motion either ignores the cases cited in appellants' Jurisdictional Statement, e.g., Austin v. New Hampshire, 420 U.S. 656 (1975); Travis v. Yale and Towne Mfg. Co., 252 U.S. 60 (1920); Williams v. Vermont, 472 U.S. 14 (1985); Westinghouse Electric Corp. v. Tully, 466 U.S. 388 (1984), or refers to factual variations in those cases that do not change the legal conclusion that appellees' actions are unconstitutional.

Appellees' assertion (motion, pp. 9-11) that there is, in fact, no disparate treatment of residents versus nonresidents is patently false: whenever a resident and nonresident have the same New York taxable income, subject to both New York and out-of-state taxes, under appellees' scenario the nonresident must pay higher taxes to New York than the resident as a result of the credit granted only to residents.[6] This is so despite the fact that nonresidents receive their basic governmental

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[6] In appellees' example (motion, p. 10 n.3), nonresident "C" pays taxes on 100 percent of his New York taxable income, while resident "B" pays taxes on only 75 percent of his New York taxable income. Therefore, through the tax credit New York subsidizes its residents by paying out-of-state taxes for them, but grants no subsidy to nonresidents, who are subjected to double taxation. This unreasonable discrimination is unconstitutional, notwithstanding appellees' citation (p. 11) of the Toomer, Goodwin, and Travelers' Insurance cases, which were based on entirely different factual circumstances that required a different result.

services elsewhere.[7]

III. Appellees' Contentions Regarding Their §637(d) Agreement With Appellants

Appellees' motion largely ignores the 1972 agreement between the State Tax Commission and appellants. However, this matter cannot be swept aside so easily.

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[7] Appellees also assert that discriminatory treatment of nonresidents is cured because nonresidents are taxed only on their New York source income (motion, p. 11). However, in Aurora Corp. v. Tully, 60 N.Y.2d 338, 345 (1983), the New York Court of Appeals expressly held that disparate treatment of residents and nonresidents cannot be justified on the basis that a resident's entire income is taxed by New York while a nonresident is taxed only on income connected to New York. The law review article cited elsewhere in appellees' motion also rejects appellees' position: "the denial of a credit to nonresidents virtually guarantees that they will be denied a credit for taxes paid to their state of residence but levied in part upon income earned in the state of nonresidence. It therefore cannot be suggested that such denial relates only to taxes that are not 'connected' with income arising from sources in the taxing state." Hellerstein, "Some Reflections On The State Taxation Of A Nonresident's Personal Income," 72 Mich. L. Rev. 1309, 1352-53 (1974).

Appellees have long conceded that Deputy Tax Commissioner Donovan entered into an "agreement" with appellants,[8] and they have similarly conceded that appellants have consistently observed and relied on that agreement to their detriment (see J.S. 10-14, 39-42). Yet, appellees' motion (p. 13) now maintains that "appellants do not claim that an application was made by any member of their partnership" for an agreement pursuant to §637(d) of the New York Tax

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[8] While referring to their "letter agreement," appellees' motion inconsistently states (p. 14) that there was "no evidence that it was approved by the Tax Commission." However, the record is clear that Mr. Donovan made an institutional decision. Also, appellees have never asserted, and do not assert now, that the agreement was not approved by the Commission. Further, appellees fail to note that appellants were prevented by the Tax Commission, with court approval, from engaging in discovery as to the Commission's records. In these circumstances, where the records were within appellees' control, appellees cannot belatedly contend, consistent with due process, that appellants failed to produce appropriate "evidence."

Law. This assertion is absolutely false. Indeed, the Tax Department's Exhibit 93 in this case expressly states that appellants formally met with officials of the Department and requested that their tax reporting method "be accepted as an alternate method of allocation as provided under the Statute [§637(d)]." So too, appellants' method was approved on November 22, 1972 by Mr. Donovan on the official stationery of the Tax Department and the State Tax Commission.

Appellees' motion (p. 13) also contends that Mr. Donovan's §637(d) agreement is invalid because there allegedly would be a loss of revenue to the state because one or two of appellants' New York partners, nonresidents of New York, reportedly allocated their income between the two offices of appellants' firm. However, appellees earlier concluded as a matter of law that any loss of income to the state

was "irrelevant" (J.S. 26a). Furthermore, appellees' new theory is totally inaccurate since the substantial profits flowing from appellants' Washington office to the New York-based partners surpassed any loss now alleged by appellees, profits that were taxed by the state (J.S. 13-14 n.3).

Finally, appellees' motion (pp. 12-13) asserts that neither due process nor contractual rights require New York to adhere to its agreement because there was "no consideration" for the agreement. This too is patently false. Appellees previously conceded that appellants consistently observed the agreement and acted in reliance on the agreement to their detriment (see J.S. 23a-24a). This clearly constitutes consideration, and appellees are thus required to abide by their

agreement as a matter of law (see J.S. 39-44).[9]

IV. Conclusion

For all the foregoing reasons, and those cited in the Jurisdictional Statement, appellants respectfully submit that this case presents substantial constitutional questions warranting this Court's plenary review. If appellees' position is allowed to stand, professionals throughout the country will be subjected to multiple taxation even though they do not practice in the taxing states. Thus, appellees' Motion To Dismiss Or Affirm should be denied.

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[9] Futhermore, as a matter of equity appellees' agreement, combined with appellants' detrimental reliance on that agreement, estops appellees from now denying the validity of their agreement. See, e.g., the following tax estoppel cases: Miller v. United States, 500 F.2d 1007 (2d Cir. 1974); Simmons v. United States, 308 F.2d 938 (5th Cir. 1962); Shuster v. Commissioner, 312 F.2d 311 (9th Cir. 1962).

Respectfully submitted,

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